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Transparency of State-Owned Enterprises in South Korea

Wonhee Lee, May 2014

Introduction

During the period of rapid economic development in South Korea from the 1960s to 1970s, state-owned enterprises (SOEs) or public enterprises played a critical role in the economic growth of the nation. SOEs invested in the kind of infrastructure, including Social Overhead Capital (SOC), where the private sector had difficulty in justifying an investment. At that time, SOEs were completely under the control of the State bureaucracy. The sole purpose was industrial development. There was no transparency or participation; their activities were out of sight and out of control by the public.

As privatization prevailed in 1980s, the situation began to change. During the movement to privatization, many problems with the past management of SOEs were brought into the open. So in 1984, for the first time, the performance of SOEs was evaluated. The existing legal basis was changed to prepare for the evaluation.

A dramatic change occurred in 1997, as the financial crisis shocked the Korean economy. At that time, many attempts were made to renovate the whole country. In line with this effort, transparency and public participation were emphasized in the realm of SOEs. As a progressive president was elected in 2002, the renovation was pushed even further. In 2007, the Act on the Management of Public Institutions (January 19, 2007) created an entirely new legal basis for SOEs. The law takes account of many kinds of advanced managerial instruments, including governance policy, transparency, and participation. But many voices still call for better the management of SOEs.
This article evaluates the current situation of SOEs in Korea discusses some implications, and outlines some directions for the future.

Development of SOEs in Korea

History of SOEs in Korea

There are five stages in the development of SOEs in Korea: Stage 1, from August 1948 to July 1962; Stage 2, from August 1962 to February 1984; Stage 3 from March 1984 to January 1999; Stage 4, from February 1999 to March 2007; and Stage 5, from then onwards.

Stage 1 is defined as the period from the establishment of the government of the Republic of Korea to just prior to the implementation of the first Five-Year Economic Development Plan. During this period, SOEs mostly reverted from Japanese colonial ownership to control by the Korean government. One of the main roles of SOEs during this period was to take responsibility for developing the infrastructure that was vital to economic development and boosting the private sector. There was no systematic managerial perspective for SOEs, and SOEs were managed through decentralized control by each of the line ministries.

Stage 2 covers the period when SOEs were actively used as a means of economic development in line with the first Five-Year Economic Development Plan. During this period, SOEs underwent quantitative expansion and quality improvement, and the Korea government adopted a government-led strategy. Aiming at rapid growth, the government supported industrial policies that protected or promoted certain industries, based on the logic of "economies of scale" and "economies of scope." In line with this policy, public enterprises were established as tools for such economic development strategies and industrial policies.[1] While many public enterprises were created during this period, the need for centralized and consistent management arose. In order to effectively carry out such policy, the Budget and Accounting Act for Government Invested Institutions (1962) and the Framework Act on the Management of Government Invested Institutions (1973) were enacted. In other words, there were two kinds of control mechanisms; budget and management.

Stage 3 is the period when, with the enactment of the Framework Act on the Management of Government Invested Institutions of 1983, an overhaul of the management structure and an evaluation system for management were sought to provide the foundation for the establishing an autonomous and accountable management system for Government Invested Institutions. During this period, the principal-agency problem was widely recognized, and the inefficiency and unaccountability of the bureaucracy and public enterprises were hot issues. So the government made attempts to reform and renovate the public enterprises. The most important of these steps was the introduction of the performance evaluation for public enterprises.

> "Aiming at rapid growth, the government supported industrial policies that protected or promoted certain industries, based on the logic of 'economies of scale' and 'economies of scope'."

Stage 4 includes the period when the Framework Act on the Management of Government Invested Institutions was amended to strengthen the autonomous and accountable management systems of Government Invested Institutions. In order to establish an accountable and responsible management system, the "CEO management contract system" was introduced while the "management publication system" and the "minority shareholder protection system" were also established to enhance management transparency and allow public scrutiny. During this period, the Kim Dae-jung Administration, the so-called "radical presidency," implemented the privatization policy as part of public-sector reforms in the aftermath of the financial crisis of 1997. Based on the results of a special inspection regarding the status of management reforms across 153 SOEs by the Board of Audit and Inspection in June 1998, the Kim Dae-jung Administration formulated the First (July 4) and Second (August 5) Plans for Management Reform and Privatization of State-Owned Enterprises aimed at

[1] At that time, SOEs, with 100 percent State ownership were less popular in South Korea than public enterprise, which can involve various degrees of State ownership.

"improving the management efficiency of State-Owned Enterprises by introducing competition principles and establishing accountable management."

Stage 5 began with the enactment of the Act on the Management of Public Institutions (January 2007). The goal of the act was to solve such problems as the existence of blind spots in management and the ambiguous classification system of SOEs and government affiliated institutions.[2] To accomplish this purpose, various legal systems were consolidated: the Framework Act on the Management of Government Invested Institutions, the Act on the Improvement of Managerial Structure and Privatization of Public Enterprises, and the Framework Act on the Management of Government Affiliated Institutions. The Act on the Management of Public Institutions has very special characteristics and provides a very important legal basis for the current managerial system of public institutions. First, it attempts to reform the classification system of all public institutions, including existing SOEs and subordinate institutions. Moreover, it aims to reform external and internal governance structures. So the decision-making system was changed dramatically. Finally, transparency, accountability, and participation were emphasized.

Classification of SOEs in Korea

Public institutions, as prescribed in Articles 5 and 6 of the Act, are classified as "SOEs," which engage in more commercial enterprises, and "quasi-government institutions," which engage in more activities in the public interest.

Under such a classification, the proportion of self-generated revenue can be used as a proxy variable. Public institutions whose self-generated revenue accounts for at least 50 percent of total revenue are classified as SOEs, while those whose self-generated revenue accounts for less than 50 percent of total revenue are classified as quasi-governmental institutions.[3]

SOEs whose self-generated revenue accounts for at least 85 percent of total revenue and assets that exceed two trillion won are designated as market-based SOEs, and the other SOEs are designated as quasi-market-based SOEs. The reason for this subdivision of SOEs is to ensure the same autonomy seen in private companies, so that the market-based SOEs can be guaranteed global competitiveness, which is, of course, a priority of privatization.

Quasi-governmental institutions are subdivided into "fund management-based" quasi-governmental institutions, which manage governmental funds, and "commissioned-service-based" quasi-governmental institutions, which execute services commissioned by the government. Greater transparency is required for the fund-management-based institutions because they manage public funds.

[2] At that time the OECD model was most influential, and there had been much academic research about governance reform. Especially in 2003 many scholars had the chance to join with the new president, and they helped drive reform.

[3] The criteria to determine the self-generated revenue are very important. The revenue from compulsory consumption specified in statutes by the government is not regarded as self-generated revenue, and only half of such revenue is recognized. The total amount of the revenue generated by the natural monopoly and consumption which is not mandatory is reflected as self-generated revenue.

Any public institutions not classified as either SOEs or quasi-governmental institutions are designated as non-classified public institutions. Table 1 shows all of these classifications graphically.

Table 1 Classification of Public Institutions

SOE	(Commercial purpose > Public interest)	Self-generated revenue/Total revenue ≥ 50 percent
	Market-based SOEs	Self-generated revenue/Total revenue ≥ 85 percent and a minimum asset size of two trillion won
	Quasi-market-based SOEs	All other SOEs
Quasi-governmental institution	(Public interst > Commercial purpose)	Self-generated revenue/Total revenue < 50 percent
	Fund-management-based quasi-governmental institutions	Institutions that manage government funds
	Commissioned-service-based quasi-governmental institutions	Quasi-governmental institutions except fund-managed-based institutions
Non-classified public institution		Public institutions other than SOEs and quasi-governmental institutions

Source: "Details Regarding the Act on the Management of Public Institutions," Ministry of Planning and Budget, 2007.[4]

Table 2 Number of Public Institutions by New Law

Total (286)	SOEs		Quasi-Governmental Institutions		Non-classified
	Market-based SOE	Quasi-market based SOEs	Fund-management-based	Commissioned-service-based	
Number	14	13	17	66	176
Budget/GDP	11.5%	6.4%	8.7%	6.0%	2.0%

Note: The non-classified public institutions are very small, with under 50 employees. So the number of non-classified institutions is very large. This is because the new law tries to embrace all kinds of public institutions.

Source: Compiled from Korea Institute for Public Finance.

Transparency of SOEs in Korea

[4] Under this law, 286 institutions are designated as public institutions and classified. When we say public enterprise or public corporation, we are referring to the narrow definition of SOEs in Korea: market-based SOEs and quasi-market-based SOEs.

Legal framework

The Korean Constitution does not specifically address the governance of SOEs, but it has a clause that requires the approval of the State Council to appoint the CEO of individual SOEs.
But from the beginning, SOEs have had a solid foundation in law. There is a long history of using public funds for development in Korea. In 2007, the legal basis was formalized in the Act on the Management of Public Institutions, which covers all the kinds of SOEs shown in Table 1.

Framework of ownership

The government makes clear its objectives for ownership of a given SOE. Each SOE For example, the role of the Korea Electric Power Corporation, one of the market-based public corporations, is manifested in the first article of the Korea Electric Power Corporation Act.

Box 1 Article 1 (Purpose)

The purpose of this article is to establish the Korea Electric Power Corporation in order to facilitate the development of electric sources, to stabilize the supply and demand of electricity by endeavoring for the efficient operation of electric utility, and to contribute to the national economy.

According to the new 2007 law, there is a clear separation between the government's role as owner of SOEs and its role as regulator of markets in which SOEs operate. The Department of Public Institution Policy, under the Ministry of Strategy and Finance (MoSF), has the role of setting policy for ownership. The MoSF also has the role of central budget agency and can regulate the organizational and financial management of all the SOEs. It is also responsible for approving strategy, appointing board members, monitoring performance, and deciding dividend policy. Meanwhile, each line ministry can regulate each SOE with regard to industrial policy. In this sense, the role of ownership is kept separate from the instrument of industrial policy, in keeping with OECD's guidelines on ownership policy.
Government exerts its ownership by the performance evaluation, which is conducted annually by external experts, under the supervision of the MoSF. This system of separating ownership and operation has been adopted and refined by the Korean government since 1984. The ownership role of the government is also clear in the appointment policy of SOEs, as spelled out in Articles 25 through 30 of the 2007 law.

Board of directors

The board of directors is the supreme decision-making body and has the authority to examine key management strategies and goals of SOEs and to supervise their overall management. The board of directors consists of no more than 15 members in two categories: standing directors and non-standing directors. Standing directors are inside the government sector, and some of them are from the line ministries responsible for the SOEs and others from MoSF. Non-standing directors are experts from outside government and SOEs. What is important is that the chairperson of the board is the senior non-standing director and that the non-standing directors constitute a majority.

Box 2 Responsibilities of the Board of Directors

- Business goals, budget, and management plan
- Use of reserve fund and carryover of budget
- Settlement of accounts
- Acquisition and disposition of fundamental assets
- Long-term borrowing, issuance of corporate bonds, and repayment plan for such loans or bonds
- Setting prices for products and services
- Appropriation of retained earnings
- Investment in and contribution to other corporation, etc.
- Guarantees for obligations of other corporations
- Amendment of the articles of association
- Establishment and amendment of bylaws
- Remuneration for executives
- Matters referred to the board by the head of the public corporation or quasi-governmental institution
- Other matters considered necessary by the board of directors

Standing directors of a public corporation are appointed by the head of the public corporation. The head is not the chairperson of the board, but the CEO. Non-standing directors of a public corporation are appointed by the MosF, after recommendations from the executive recommendation committee and consultation with the management committee, an advisory committee for the MoSF, any number of people who have knowledge and experience in the area.

Standing directors of a quasi-governmental institution are appointed by the head of the public institution and chosen from among those recommended by the executive recommendation committee. Non-standing directors of a quasi-governmental institution are appointed by the head of the responsible ministry and chosen from those recommended by the executive recommendation committee after consultation with the management committee. The power to appoint board members underlines the importance of the MoSF and the executive recommendation committee.

CEO

The head of a public corporation is appointed by the President on the recommendation of the head of the responsible agency and chosen from a number of people nominated by the executive recommendation committee and then selected through consultation with the management committee. Even with a recommendation by a committee, the final decision for the appointment of the head of public corporation is made by the president. The head of a public corporation is not to be removed earlier than the expiration of his or her term unless under the provisions of Articles 22 (1), 35 (3), and 48 (6) or if there is grounds for removal as specified in the articles of association.

The head of a quasi-governmental institution is appointed by the head of the responsible agency from those people recommended by the executive recommendation committee.

Even though the CEO is protected from political intervention by a solid legal basis, this guarantee can be easily broken if a newly elected President wants to remove a CEO. After the presidential election in 2007, the government in 2008 changed 131 CEOs whose term had one or two years remaining. Many Koreans think this is a most serious problem. Even though term is guaranteed by law, a newly elected President can override it. This is the legacy of the spoils system.

Inspector

The inspector of a public corporation, whose role is to review daily business and seek to prevent fraud and waste, is appointed by the President on the recommendation of the Minister of Strategy and Finance from a number of people recommended by the executive recommendation committee and then selected in consultation with the management committee. However, the inspector of a public corporation that is smaller than a size prescribed by a Presidential Decree, is appointed by the Minister of Strategy and Finance, rather than the president, but still chosen from those recommended by the executive recommendation committee and after consultation with the management committee.

Relationship with government policy

There are many reasons for the establishment of SOEs by the government. As each SOE is established, its main purpose is to carry out particular governmental policies. In Korea, SOEs are expected to implement government-led economic development strategy, and there have been enormous official and unofficial obligations. The noncommercial obligations imposed by government result in deficit and debt for the SOE.

In 2007 the newly elected President wanted to reconstruct the four main rivers. To combat the economic downturn, SOEs were called on to support government stimulus plans through higher spending. But the political opposition opposed such fiscal expenditure. The President could not get the measures through the National Assembly and so used an SOE instead. The Water Resource Corporation, which constructs and manages large dams, was put in charge and assumed a burden of 8 trillion won (approximately US$7.8 billion).[5] It was allowed to issue bonds whose burden will eventually fall to the government, as it is quite likely that in the near future the government will assume this debt in order to develop and finance new projects.

Similar burdens are evident in other areas of the economy. Since the 2000s, inflation in land and housing has been a chronic problem. So the new president wanted to build more houses. The burden was given to the Land and Housing Corporation. To fulfil the mission, the SOE issued bonds, which will eventually increase the debt.[6] And the Railway Corporation is expected to implement the Public Service Obligation (PSO), which is to give free rides for soldiers and old people, at a cost of 500 billion

[5] In 2011 the budget of the Land, Transportation, and Maritime affairs was 23 trillion won. So this figure amounts to 34.8 percent of the total budget.

[6] If the houses will be sold as scheduled, there will be no problem. But the circulation is not good enough, the cost will be debt.

won. Every year there is a budgetary negotiation between government and the Railway Corporation. And even though the government tries to adjust the PSO, it remains far below the requested amount.

These kinds of obligations will eventually increase the debt as is shown Table 3. The SOE must ultimately follow the government guidelines because the president has the final authority to appoint the CEO. In addition, government can give a subsidy to SOE. This is the reason for the moral hazard of SOE management. Even though there is deficit or loss, the government will eventually take the responsibility.

Table 3 Debt of the Main SOEs (in US$ million)

	Organization	2010	2011	Increase	Percent Increase
1	Agriculture and fisheries	121,526	130,571	9,044	7.4%
2	Industry and services	72,241	82,664	10,422	14.4%
3	Horizontal objectives	27,223	40,488	13,263	48.7%
4	Specific sectors	22,294	27,966	5,672	25.4%
5	Transport	23,728	24,591	864	3.6%
6	Shipbuilding	15,870	20,800	4,929	31.1%
7	Radio and television	13,979	15,567	1,587	11.4%
8	Tourism	15,563	15,112	-451	-2.9%
9	Other sectors	12,623	13,456	832	6.6%
10	Rehabilitation and restructuring	8,085	12,581	4,495	55.6%

Note: As of 2011, government debt is 350 billion dollars. Source: National Assembly Budget Office. (2010).

Table 4 Governmental Support for SOEs in 2012 (millions of Won)

	Contribution	Investment	Subsidy	Loan	Total Sum
Market type SOE	0	8,428	3,561	2,316	**14,304**
Quasi-Market SOE	138	29,511	9,787	684	**40,121**

Source: National Assembly Budget Office. (2011).

Information Availability

Alio System for SOEs.[7]

All the information regarding SOEs in South Korea is published for citizens on the website www.alio.go.kr. This website is managed by the government.[8] We call it the "Consolidated Publication System" because all the information on SOEs is published on the site.[9] This is an important and convenient site for collecting data about SOEs. On the website, there are the items as is shown Table 4. Even though

[7] The Korean word "Alio (알리오)" means "making public."

[8] There is a public think tank to support the Alio system. The Korea Institute of Public Finance, which was founded by government, has a Research Center for State Owned Entities that has the task of providing research on SOEs.

[9] The government has another website that makes budget data available: www.dbrain.go.kr (digital brain system).

there is not a succinct report that enables users to understand an entire SOE at a glance, the site contains many kinds of information related to SOEs. In addition, the government publishes the financial report of each SOE. And the citizens can obtain a clear view of the overall performance and evolution of the SOEs, including the state's portfolio of SOEs and the main financial indicators for the most recent reporting period. This kind of "Consolidated Publication System" is prescribed by law.

Table 5 Composition of Consolidated Publication Items

Categories	*Items*
I. General Status	General status
II. Operation of Institution	Number of employees Status of executives New employment Annual salary of executives Average monthly salary of employees Business expenses spent by head of institution Welfare expenses Details of executive business trips overseas Status regarding to labor unions Rules of employment
III. Management Performance	Balance sheet Income statement Revenue and expenditure Core projects Details of investment execution Capital and shareholders Short and long term borrowings Investment and contribution Annual endowments and grants Management of overhead costs
IV. Internal and External Evaluation	Feedback from National Assembly Feedback from Board of Audit and Inspection/ responsible ministries Results of management performance evaluation Feedback of management performance evaluation Results of customer satisfaction surveys Results of auditor's job performance evaluation Minutes of director's meeting and results of internal audit
V. Announcement	Examples of management innovation Employment information Bidding information Research report Other information

Source: Act on the Management of of Public Institutions of 2007

Individual Publication by Each SOE

In addition to the consolidated publication site managed by the government, individual SOEs publish regular, timely, and informative annual reports and disclose them on their own websites. Of course, the annual report is also submitted to the government and is made public to citizens. Every SOE should also undergo a financial audit, which can publish its financial and operating results, remuneration policies, related party transactions, governance structures, and governance policies. As this information is open to all in the Alio system, it is easy to compare and analyze the current situation for any SOE.

SOEs also report payments to the government of such items as taxes and royalties, as well as reporting the financial support received from the government, such as a guarantee of loans. The cost of noncommercial obligations imposed on SOEs is published in the annual reports and is also included in the individual budgets. With regard to these kinds of preferences or burdens, the National Assembly always monitors in an effort to find any problems.

The government adopted the (International Finance Reporting System) for the market-based public corporations in 2012. This year, every SOE included in this category published its finance report according to the new system.

Some SOEs try to publish a "sustainability report," which is recommended by the UN. This report is expected to include the SOEs efforts to be socially and environmentally responsible. As of 2010, 167 Korean companies had joined the UN Global Compact, of which 30 companies were SOEs. However, there is no governmental policy to encourage SOEs to join the Global Compact, and the CEO or the board of each SOE decides whether or not to join.

The performance evaluation system plays a very important role role with regard to transparency, and it applies to all SOEs. Though the evaluation is managed by the Ministry of Finance and Strategy, external experts, including university professors and Certified Public Accounts, carry out a substantial evaluation. During the evaluation by external experts, all the information with the SOE can be examined, and the results are open to the public through the press and the Alio system.

Oversight

Administrative authority

Each line ministry can supervise related SOEs and has significant power over them. Each line ministry can establish SOEs in its area of responsibility and can draft and propose specific legislation to govern them.

In addition, the Ministry of Finance and Strategy exerts its ownership policy. For example, the MoSF announced that all the market-based public corporations should adopt the IFRS from 2012, and, in accordance with IFRS guidelines, all of the SOEs published a financial report. MoSF also has the power to control staffing, organizational structure, and subsidy policy through the budgetary process and performance evaluation.

All SOEs are subject to being audited and inspected by the Supreme Audit Institution. The Board of Audit and Inspection of Korea has this power over SOEs by law. BAI has carried out the audit and inspection process every year and published the results. That report is essential for locating and combatting fraud, wasteful expenditures, and misdemeanors. BAI doesn't do performance audits, but it can review the performance evaluations made by the evaluation committee.

Legislative power. The National Assembly has enormous power to investigate and audit SOEs. The National Assembly can conduct one of two kinds of investigation: a comprehensive investigation every year or a focused investigation of a specific issue raised by some legislators. In this way, each standing committee investigates its SOEs every year. Records of the work of the standing committees are publicly available, though citizens are not allowed to submit opinions.

There are specialized committees of the legislature that scrutinize strategies, expectaitons, and performance of SOEs. This kind of oversight is included in a general investigation.

Internal inspection

Individual SOE boards are held accountable for their actions. They bear final responsibility for management of the SOE, so they can supervise all kinds of activities.

Every SOE is required by law to have an internal oversight mechanism. The market-based public enterprises have their inspection boards, while the quasi-public institutions have the department of inspection.

But one problem is that, given Korean culture, it is difficult for the internal oversight effort to have much impact. As the organizational culture of a Korean company resembles a family, the remission overwhelmed the members. Even when some wrongdoing was discovered, it is not always disclosed. This is a typical bureaucratic phenomenon in Asian cultures.

Performance Evaluation System

By law, all SOEs are subject to external performance evaluation, and such evaluation is very important for managing SOEs in South Korea. A management evaluation manual for SOEs and quasi-governmental institutions is prepared by the end of the year preceding the year of assessment. An autonomous management plan is then formulated for performance evaluation early in the year when management evaluation is to be conducted. As a result, public institutions are managed in annual cycles, and performance evaluation is carried out at the beginning of the following year.

Article 47 of the Act on the Management of Public Institutions prescribes that a management performance report and a management implementation report be submitted to the Minister of Strategy and Finance and the head of the responsible ministry by no later than 20 March each year. Article 48 (7) of the same act stipulates that, based on these reports, the evaluation is to be finished no later than 20 June of each year and the results shall be reported to the president and the National Assembly. Performance evaluations are scheduled to be completed by late April.

Committee for coordinating the evaluation

In accordance with the Act on the Management of Public Institutions, enacted in January 2007, the Committee for Management of Public Institutions was established in April of the same year. The act stipulates that the committee is to be under the control of the Ministry of Strategy and Finance for its deliberations on the managerial agendas of public institutions. The committee is made up of government members and up to 11 private-sector members. Government members include the Minister of Strategy and Finance, an official at the vice-ministerial level from the Prime Minister's Office, a vice minister from the Office of Public Administration and Security, and a vice minister from other responsible ministries. The Minister of Strategy and Finance is the chairperson. Private-sector members are appointed by the President on the recommendation of the Minister of Strategy and Finance. They are chosen from various fields, such as law, economy, press, academia, and labor unions, for their extensive knowledge and experience in management public institutions as well as for their reputation for impartiality.

Currently, nine private-sector members are on the committee. Their term lasts three years, and there is no regular payment for them. When there is a meeting, their expenses are covered, and they can be paid per day.

Roles and responsibilities of the evaluation committee

The committee considers on matters regarding the designation of public institutions, the policies for their advancement, their general management, the appointment and removal of their executives, and their general supervision.

Established in April 2007, the committee held a total of 35 meetings up through January 2011, and, as a result, a total of 178 agenda items were taken up. Meanwhile, when a detailed explanation on agenda items is required at a time between the regular meetings, preliminary presentations are held for private-sector members. The results of the committee's decisions are open in principle. Thus the committee plays an important role in managing all public institutions in Korea.

Special team for evaluation

In order to ensure expertise and fairness in the course of assessments, a special team for evaluation, made up of experts from the private sector, including professors and accountants, is formed according to Article 48 (6) of the 2007 law. Accountants conduct the quantitative portion of the evaluation, while professors and other experts conduct the qualitative side of the evaluation. Annually, around 70 experts participate in the evaluation.
The special team for performance evaluation is formed in February or March of the preceding year. Some training courses, including workshops, are offered to team members. To improve the validity of evaluation, on-site interviews with the staff at public institutions are held through April and May.

Methodology

Index

There are 18 indicators (displayed in Table 6) used for the evaluation of management performance, and they are divided into three categories: leadership and strategy, management system, and business performance.

Table 6 Categories and Indicators of the Evaluation System

Category	*Main Contents*	*Main Indicators*
Leadership and Strategies	Whether business development drivers, including vision, goals, strategies, and leadership, are properly set up and implemented.	• Executive leadership • Internal supervisory system including board of directors and auditors • Vision and development of strategies, plans in pursuit of major business activities
Management System	Whether the institution has a system that improves efficiency of business activities and utilizes organizational resources effectively.	• Major business activities • Organization, personnel, remuneration, financial management, rational labor-management relations, performance management system, etc.
Management Performance	Whether management performance, including major business performance, productivity, and customer satisfaction, is properly conducted.	• Major business performances reflecting focal business • Customer satisfaction • Labor and capital productivity • Management of personnel and overhead expenses

Weighting

The law of 2007 classifies the public institutions according to their commercial focus. Different evaluative methodologies and indices are adopted for different typologies.

The ratio of qualitative indicators to quantitative for public corporations is 40:60, whereas the ratio of qualitative to quantitative for quasi-governmental institutions is 50:50. This difference reflects that the public corporations are more commercial, and so the quantitative indicators are given more weight.

And the weight of each index is different from type to type. The evaluation system is customized to each public institution.

Table 7	Weight of index by type		
Category	*Unit of Index*	*Public Corporation*	
		Qualitative	*Quantitative*
Leadership	1. Leadership	5	
	2. Responsible management	3	
	3. Customer satisfaction		5
	4. Contribution to society I. Social contribution II. Compliance to government policy	2	5
	subtotal	**10**	**10**
Management Efficiency	1. Organizational efficiency		8
	2. Organization, personnel management	4	
	3. Financial management and performance I. Financial management II. Financial performance III. Quantitative managerial cost	4	6 2
	4. Salary and performance I. Salary management II. Total remuneration increase	4	4
	5. Labor relations	3	
	subtotal	**15**	**20**
Major Projects	**subtotal**	**25**	**30**
Total		**40**	**60**

For the qualitative evaluation, the grade is divided into six levels and is decided by professors and experts.

Table 8	Qualitative Grade for Evaluation
Grade	*Point*
S	100
A	90
B	75
C	60
D	45
E	30

A detailed methodology is adopted for the quantitative evaluation; trend analysis, β distribution, performance/target comparison, and so on. To do this, some statistical logic is adopted.

Recently, a customer satisfaction survey was adopted to judge the mood of market. Its scheme is something like a private business survey. To do this, independent social research organizations survey customer satisfaction every year. Then the evaluative committee adopts the results. All the detailed points and grades are made public on the website.

Feedback system

Calculated by combining evaluation points in each grade, the comprehensive performance evaluation is categorized by six grades: excellent, outstanding, good, average, poor, and very poor. Grade ranges are determined through deliberation and resolution by the Committee for Management of Public Institutions, based on average scores and the standard deviation obtained from the actual performance evaluation of institutions.

The results of the management evaluation are mainly used in four areas related to personnel measures, payment of incentives, budget feedback, and management improvement. First, for the personnel measures, the Minister of Strategy and Finance is allowed to recommend the dismissal of the heads concerned or standing directors of institutions rated "poor" in the performance evaluation. Second, the evaluation results have been used as a standard for determining the levels of incentives offered to executives and employees. Different incentive rates are applied according to the performance-based decision of the Committee for Management of Public Institutions. The range is from 0 percent to 500 percent, according to the results. This strong incentive system makes the evaluation more effective. Third, institutions rated "excellent" may increase their expense budget for the following year by 1 percent, while those rated "poor" are required to decrease the budget by 1 percent. This means that government controls the individual expenses according to the performance. Fourth, institutions evaluated "poor" can be provided a variety of support, including management consultation and assistance for improving management activities through oversight. They should also submit management improvement plans.

Public Participation

Public hearings. Even though there is by law an opportunity for the public to provide written or oral comments and input during legislative discussions or hearings on SOEs, it is not easy to find examples where this happened. The legislative process still takes place largely behind closed doors. The real story of pork barrel politics is under the table.

And there are no specific laws or regulations that provide for civil society participation in any form in activities relating to SOEs in general or to specific SOEs, e.g., requirements for public consultation on changes to fees or other terms of service delivery.

But there can be individual or special cases for participation. When the Land and House Corporation plans to construct a new district, there is a public hearing on the environmental impact, but such public hearings are very limited.

Information disclosure

In 1996, the Freedom of Information Act was passed at the National Assembly. It can be applied to all areas of the public sector, including central and local government and SOEs. So civil society has a legal basis to access the information regarding SOEs. In reality, however, there have been no striking cases of information disclosure. This is due to the fact that on one hand that there are many kinds of mechanisms governing SOEs and on the other hand that the civil society does not focus seriously on SOEs.

What is important for gathering the information on SOEs is the Consolidated Publication System, the so called Alio system, which is managed by the government. This website is well-designed and supplies good information for civil society groups, academics, think tanks, business associations, and other entities outside government. The Research Center for State Owned Entities, which is affiliated with the Korea Institute of Public Finance, analyzes and publishes very important reports, and it provides important information for understanding SOEs.[10]

Customer satisfaction survey

In 1999 the government first performed a customer satisfaction survey for public institutions. In 2004 it was extended to government-affiliated institutions. And in 2007, when the Act on the Management of Public Institutions was implemented, the survey was enshrined in law.

Box 3 Article 13(2) of the Act on the Management of Public Institutions

Every Public Institution that provides services directly to the people shall conduct a customer satisfaction survey at least once a year. In this case, the Minister of Strategy and Finance may instruct public institutions to conduct a consolidated survey on customer satisfaction levels and integrate the results of such surveys for publication.

In conducting these surveys, the National Customer Satisfaction Index, developed by the Korea Productivity Center and based on the American Customer Satisfaction Index, had been used as the survey model beginning 1999. But there has been trial and error to develop a unique survey model to reflect the characteristics of public institutions. In 2004, the Korea Management Association Consultants and Seoul National University developed the Public Service Customer Satisfaction Index, and it has been applied to all customer satisfaction surveys for public institutions since then.

Reflecting the surveys, there has been a remarkable quantitative improvement, with customer satisfaction with SOEs increasing by 34.8 points over 11 years.

10 KIPF is one of the public research organizations founded by the government. Every year, the government gives a subsidy for managing KIPF, and KIPF publishes many reports and materials for making SOE policy.

Table 9	Trend of Public Service Customer Satisfaction Index (in points)						
	1999	*2004*	*2007*	*2008*	*2009*	*2010*	*2011*
SOEs	58.1	79.4	89.2	89.3	92.0	92.9	93.7
Quasi-governmental institutions		72.5	82.2	84.1	86.7	88.1	89.6
Other public institutions			79.1	81.1	82.7	84.6	86.9

It is obvious that the customer satisfaction survey has been a successful stimulus to help reinforce the sense of social responsibility at public institutions and win public trust and support.

Executive recommendation committee

The right to appoint personnel for public institutions is summarized in Table 10. During the appointment procedure, the executive recommendation committee is important, and it can be a channel for external experts to participate.

Table 10	The Right to Appoint Personnel for Public Institution	
	Public Corporation	*Quasi-governmental Public Institution*
Board Member		
Standing Member	CEO	CEO
Non-standing member	Minister of Strategy and Finance (executive recommendation committee) • Management committee	Competent Minister
CEO	President (executive recommendation committee) • Management committee • Competent Minister	Competent Minister (recommendation by executive recommendation committee)
Inspector	President (executive recommendation committee) • Management committee • MoSF	MoSF (executive recommendation committee) • Management committee

According to the 2007 law, every public corporation and quasi-governmental institution is to have an executive recommendation committee for recommending candidates for senior executive positions. The executive recommendation committee is composed of non-standing directors of the public corporation or the quasi-governmental institution and the members appointed by the board of directors. Neither executives, employees of a public corporation or a quasi-governmental institution, nor public officials may become members of the executive recommendation committee. The fixed number of the members appointed by the board of directors is to be less than one-half of the fixed number of the members of the executive recommendation committee. The chairperson of the executive recommendation committee is to be a committee member elected by the other committee members and chosen from among non-standing directors of the public corporation or the quasi-governmental institution.

The most important role of the executive recommendation committee is to recommend the candidates for senior executive positions who have good knowledge and experience relating to corporate management and business affairs of a public corporation or a quasi-governmental institution. In order to recommend candidates for executives, the committee may invite the general public to express its opinion on the candidacy, as prescribed by presidential decree, by publishing the procedure in the daily newspaper.

With regard to the appointment of the institution head, the board of directors prepares a draft agreement that contains the specific business goals that the institution head is to achieve during his or her term of office, along with a performance-based compensation plan, and delivers the draft to the executive recommendation committee. The executive recommendation committee, upon receiving the draft agreement, negotiates the terms and conditions of the agreement with the people whom the committee considers recommending as candidates for the institution head. The committee informs the head of the responsible government agency of the result of its deliberations. In this case, the executive recommendation committee may revise, amend, or modify the contents, terms, and conditions of the draft agreement partially, if necessary, for negotiation with the candidates.

"In order to recommend candidates for executives, the committee may invite the general public to express its opinion on the candidacy, as prescribed by presidential decree, by publishing the procedure in the daily newspaper."

Finally, the head of the responsible government agency, after consultation with the Minister of Strategy and Finance, executes an agreement with the person to be appointed to the institution head in accordance with the draft agreement as negotiated.. In this case, the head of the competent agency may further negotiate the terms and conditions of the agreement with the person to be appointed institution head to agree on the terms and conditions different from those of the draft agreement.

Implications of South Korean Case

SOEs have contributed to the South Korean style of rapid government-led development. The government used the SOEs as policy instruments, and so SOEs in Korea cover enormous areas of the economy.

But after the 1997 financial crisis, the strategy began to change. Attempts were made to renovate the SOEs. In this context, the basic law for SOEs was enacted. With a 60-year history of economic development, the policy for SOEs in Korea has pros and cons.

Good practices

First, a new classification was adopted for all the public institutions, reflecting the share of government investment and the degree of commercialization.

Second, ownership policy is important. The Ministry of Strategy and Finance has the role of controlling and coordinating all public institutions. Even though each line ministry has the role of economic and social policy making with regard to each public institution, the MoSF has the role of ownership policy, which makes its managerial perspective important. In this sense, the Committee for Management of Public Institutions is worthy of attention.

Third, the performance evaluation system is well developed, and it contributes to transparency and participation. Different weights for different SOEs were implemented, so that we can say that the evaluation is customized for each type of SOE. Every year about 100 external experts participate. The evaluation system will, without a doubt, be the biggest engine to guarantee innovation and accelerate accountability. This kind of evaluation system is one of the ODA (Official Development Assistance) programs in Korea.

Fourth, the online consolidated publication system, also called the "Alio system," is a good mechanism for maintaining transparency.
Fifth, the executive recommendation committee is a good device for allowing external experts to participate in the appointment of the CEO and directors of SOEs. It helps maintain transparency.

Sixth, MoSF has made many efforts to follow the global standards, by adopting the IFRS, recommending that SOEs join the UN Global Compact, and publishing a sustainability report.

Limitations

It is true that much achievement and development appear to have taken place. But there should be continuous attempts to improve the functioning of SOEs. Here are some problems to be overcome.

First, SOEs are always criticized for inefficiency, high salaries, high liabilities, and moral hazards. As employment conditions are guaranteed by career systems, employees do not always take responsibility for low productivity. This means that transparency and public participation are needed.

Second, the existing efforts to create transparency, may not be sufficient. Only experts, including professors, are given the opportunity. It is a more difficult matter to overcome the limited participation and bring in the views of citizens at large.

Third, the governance structure seems to be transparent, but it is ultimately determined by political influence. Even though Korea has a refined procedure with the executive recommendation committee and the Committee for Management of Public Institutions, the actual appointments reflect political considerations influenced by the president. It is important to overcome the discrepancy between the formal framework and informal reality.